

CALIFORNIA INFRASTRUCTURE AND ECONOMIC DEVELOPMENT BANK

STAFF REPORT

ISSUE: Staff requests approval of a clarification and restatement of the terms of the preliminary loan guarantee commitment granted to the Imperial Irrigation District (the "IID") on June 27, 2003 and an extension of the term of that preliminary commitment as so clarified and restated (the "Clarified Preliminary Commitment") until June 30, 2010.

The proposed clarification and restatement of terms and conditions is set forth in **Attachment 1**, as more fully described in this staff report.

BACKGROUND INFORMATION: The I-Bank is authorized under the Bergeson-Peace Infrastructure and Economic Development Bank Act (the "Act") to insure all or part of any series of bonds issued by a sponsor (as defined in the Act) using funds available therefore on deposit in the California Infrastructure Guarantee Trust Fund (the "Guarantee Trust Fund").

On May 13, 2003, the IID submitted an application seeking a preliminary loan guarantee commitment (the "IID Preliminary Application") in accordance with certain proposed criteria, priorities and guidelines of the I-Bank. The IID Preliminary Application requested financial assistance in issuing revenue bonds required to finance \$150 million of net project costs of a water supply project consisting of water conservation measures designed to assure that California would continue to receive the maximum amount of water from the Colorado River (the "Proposed Water Conservation Project").

On May 28, 2003, the I-Bank Board adopted Resolution No. 03-16, which adopted criteria, priorities and guidelines (the "Criteria") to implement a guarantee program for the purpose of providing financial assistance so that the IID could issue revenue bonds to finance the Proposed Water Conservation Project (the "IID Guarantee Program"), and authorized the Executive Director of the I-Bank to transfer \$20 million from the California Infrastructure and Economic Development Bank Fund to the Guarantee Trust Fund for the IID Guarantee Program. A copy of the staff report presented on May 28, 2003 and Resolution No. 03-16 are attached as **Attachment 2**.

Thereafter \$20 million was transferred to the Guarantee Trust Fund, and as a result of investment earnings, the amount on deposit in the Guarantee Trust Fund for the IID Guarantee Program is currently approximately \$24.1 million.

On June 27, 2003, the I-Bank Board adopted Resolution No. 03-18, finding that the IID Preliminary Application was consistent with the Criteria and the Act, and approving a preliminary loan guarantee commitment for the IID on the terms requested in the IID Preliminary Application (the "2003 Preliminary Loan Guarantee Commitment"). The 2003 Preliminary Loan Guarantee Commitment, as adopted pursuant to Resolution No. 03-18, was to expire:

- On December 31, 2003, if the IID had not entered into a quantification settlement agreement and related water transfer agreements with the San Diego County Water

District (the “SDCWD”), the Metropolitan Water District of Southern California (the “MWD”) and the Coachella Valley Water District (the “CVWD”), as described in Resolution No. 03-18 (collectively, the “Agreements”); and

- On December 31, 2009, unless extended in writing by the I-Bank Board.

A copy of the staff report presented on June 27, 2003 and Resolution No. 03-18 are attached as **Attachment 3**.

A quantification settlement agreement between the IID, MWD and CVWD, and a variety of water transfer agreements, including a fourth amendment to the IID and SDCWD water transfer agreement were entered into on October 10, 2003 (the “QSA and Related Agreements”), thus meeting the December 31, 2003 deadline established by Resolution No. 03-18.

Throughout 2009, staff and representatives of the I-Bank and the IID have engaged in discussions regarding the issuance of a final loan guarantee pursuant to the terms of the 2003 Preliminary Loan Guarantee Commitment prior to the December 31, 2009, deadline. On October 1, 2009, the I-Bank received an application from the IID for a final loan guarantee pursuant to the 2003 Preliminary Loan Guarantee Commitment (the “IID Final Guarantee Application”). I-Bank staff have determined that the IID Final Guarantee Application is substantially complete for purposes of meeting the application deadline of the Criteria.

However, the IID Final Guarantee Application seeks a final loan guarantee with terms that I-Bank staff are unable to conclude are consistent with the terms of the 2003 Preliminary Loan Guarantee Commitment. Because I-Bank staff are unable to make a final loan guarantee recommendation to the I-Bank Board by the 2003 Preliminary Loan Guarantee Commitment expiration deadline of December 31, 2009, I-Bank staff are now seeking clarification from the I-Bank Board of the terms of the 2003 Preliminary Loan Guarantee Commitment and I-Bank staff and IID are seeking an extension of time in order for I-Bank staff to draft a staff recommendation regarding a final guarantee to the I-Bank Board accompanied by guarantee agreements and reimbursement and indemnification agreements consistent with the Clarified Preliminary Commitment.

POTENTIAL FISCAL IMPACTS OF A FINAL GUARANTEE: As discussed in prior meetings of the I-Bank Board, granting a final guarantee pursuant to either the 2003 Preliminary Loan Guarantee Commitment or the Clarified Preliminary Commitment would have the result of committing the approximately \$24.1 million presently held in the Guarantee Trust Fund for a period of 30 years. Further, in the event the Legislature establishes a “reserve account requirement” pursuant to Government Code Section 63063, and subsequently determines to annually appropriate funds to fund draws under a final guarantee in the amount of that requirement, a final guarantee could have a potential General Fund impact of up to approximately \$350 million.

In the event the 2003 Preliminary Loan Guarantee Commitment is not extended, the approximately \$24.1 million currently held in the Guarantee Trust Fund would be available for return to the California Infrastructure and Economic Development Bank Fund to be used for

other I-Bank programs, including, without limitation, the Infrastructure State Revolving Fund Program to finance public development facilities, or for eligible I-Bank administrative expenses.

EXTENSION OF THE 2003 PRELIMINARY LOAN GUARANTEE COMMITMENT: I-Bank staff recommends that the 2003 Preliminary Loan Guarantee Commitment, as clarified and restated in the Clarified Preliminary Commitment, be extended until June 30, 2010 for the purpose of providing I-Bank staff and IID staff and representatives sufficient time to draft final guarantee agreements and reimbursement and indemnification agreements consistent with the Clarified Preliminary Commitment, and substantially final documents for the IID bonds that reflect the terms of the final guarantee agreements and reimbursement and indemnification agreements. Given the status of discussions with the IID, the I-Bank staff have determined that a six-month extension should allow sufficient time to prepare a staff recommendation and the related final guarantee documents for the purpose of obtaining the I-Bank Board's approval of the final terms of the final guarantee and reimbursement and indemnification agreements.

REQUESTED CLARIFICATION AND REINSTATEMENT OF GUARANTEE TERMS AND CONDITION: I-Bank staff and IID staff and representatives have reached an agreement of certain terms and conditions of the 2003 Preliminary Loan Guarantee Commitment, and now propose to clarify and restate these terms and conditions. However, there are still four significant unresolved guarantee terms, more fully discussed below.

IID staff and representatives and I-Bank staff have agreed that the terms set forth in **Attachment 1** in the column entitled "**Clarification and Restatement of the 2003 Preliminary Loan Guarantee Commitment**", except for the four terms for which there is a corresponding proposal in the column entitled "**IID Proposal**", are acceptable terms and conditions for a final loan guarantee. I-Bank staff are of the belief that the terms set forth in the column "Clarification and Restatement of the 2003 Preliminary Loan Guarantee Commitment" are within the scope of the Criteria for the IID Guarantee Program.

The four terms set forth in the column entitled "IID Proposal" are terms proposed by IID in lieu of the corresponding terms in the column entitled "Clarification and Restatement of the 2003 Preliminary Loan Guarantee Commitment." I-Bank staff confirms that the term set forth in the column entitled "IID Proposal" related to the "Amount of the Guarantee", which if approved would permit the issuance of Guaranteed Bonds any time prior to December 31, 2015, is not inconsistent with the terms of the Criteria for the IID Guarantee Program. However, this IID proposal is not recommended by I-Bank staff for the reasons set forth in this staff report. I-Bank staff are not able to confirm that the other three terms set forth in the column entitled "IID Proposal" are clearly within the scope of the Criteria for the IID Guarantee Program.

Discussion Of "IID Proposal":

- 1. IID's Proposal Regarding The Purpose of the Guarantee:** IID and I-Bank staff agree that the IID Guarantee Program is for the purpose of addressing certain financial risks to IID and to enable IID to issue sufficient revenue bonds to finance a water supply project that meets the requirements of the Criteria. (Criteria, Section B). However, IID and I-Bank staff do not

agree as to what financial risks the 2003 Preliminary Loan Guarantee Commitment was intended to address.

IID asserts that the purpose of the IID Guarantee Program is to protect IID in the event that any loss of revenues received by IID from the sale of water made available for sale as a result of the Proposed Water Conservation Project ("Conserved Water Revenues"), except as a result of actions approved by or undertaken by the IID, is insufficient to pay debt service on the IID's bonds guaranteed by the I-Bank, and that the 2003 Preliminary Loan Guarantee Commitment was intended to provide a guarantee to cover all such loss of revenues. This would include, for example, reductions in Conserved Water Revenues as a result of willful default by any purchaser of conserved water; as a result of any court-ordered delay or termination of transfers or purchases of conserved water or any court order requiring the IID to cease any Conserved Water Revenue generating activity in order to comply with environmental laws, ordinances, regulations, approvals, agreements or permits; as a result of force majeure (war, Act of God, etc.) or as a result of cessation by IID of any Conserved Water Revenue generating activity upon a reasonable determination by IID that such cessation is necessary to prevent an IID violation of environmental laws, ordinances, regulations, approvals, agreements or permits.

In the context of determining whether to adopt this interpretation of the purpose of the IID Guarantee Program, it is relevant that the validity of the QSA and Related Agreements, which are the source of IID's Conserved Water Revenues, are currently being litigated in the Sacramento County Superior Court as the "QSA Juedicial Council Coordinatio Proceeding No. JC4353", and on December 10, 2009, the trial court issued a tentative ruling determining the QSA and Related Agreements are invalid. A final non-appealable determination on the validity of the QSA and Related Agreements is likely to be delayed by appeals and be several months away, and a favorable decision upholding the validity of these documents is not certain. I-Bank staff recommend that any approval of a Clarified Preliminary Commitment that includes the IID's proposal regarding the purpose of the IID Guarantee Program (which approval is not recommended by I-Bank staff), should at a minimum exclude any loss of Conserved Water Revenues resulting from this pending litigation.

I-Bank staff has reviewed the Criteria approved by the I-Bank Board (Attachment 2), and cannot conclude with certainty that the purpose of the IID Guarantee Program as originally envisioned was for any other purpose than to protect IID from the financial risk of early termination of the QSA and Related Agreements as that risk of early termination was disclosed to the I-Bank Board in July of 2003. One of the anticipated termination events disclosed to the I-Bank Board in 2003 no longer exists due to subsequent environmental cost assistance provided by the Department of Water Resources. The only remaining anticipated termination event is that of "Non-consensual Termination of the 1998 IID/SDCWA Transfer Agreement" as defined in the QSA and Related Agreements. In sum, it is the I-Bank staff's conclusion that the only financial risk clearly anticipated by the I-Bank Board when it adopted the 2003 Preliminary Loan Guarantee Commitment that remains is termination by SDCWA in 2038 following notification in 2018 that an acceptable agreement regarding water wheeling rates had not been achieved. The specific language in the IID/SDCWA Transfer Agreement as it currently exists is as follows:

Article 4, Section 4.1(c) of Revised Fourth Amendment to Agreement Between Imperial Irrigation District and San Diego County Water Authority for Transfer of Conserved Water

4.1(c) Early Termination. The Authority may elect to terminate at the end of year 35 [2038] if conditions identified in (ii) below are satisfied;

* * * * *

(ii) Actual Wheeling Rate Trigger and Notice – If the Actual Wheeling Rate as determined [through negotiation, arbitration or litigation by year 15 (2018)] exceeds one-hundred twenty-five percent (125%) of the Base Wheeling Rate or the Authority has been unable to reach agreement with MWD or complete binding arbitration, litigation or other dispute-resolution mechanism, then the Authority has the right to terminate this Agreement for Transfer of Conserved Water as of the end of Agreement Year 35 [2038], but only if the Authority gives notice of such early termination no later than the end of Agreement Year 15 [2018].

2. **IID's Proposal Regarding the Schedule for Issuing Guaranteed Bonds Set Forth in the "Amount of Guarantee" Term/Condition:** The Criteria established a termination date for any preliminary loan guarantee of December 31, 2009, unless extended by the I-Bank Board. I-Bank staff and IID staff and representative have been in discussions regarding the terms of a final loan guarantee for most of 2009. During that time IID consistently represented its intention to issue at least one series of Guaranteed Bonds in 2010. The proposed six month extension of the Clarified Preliminary Commitment was established in large part as a result of this representation.

On December 10, 2009, IID proposed an amendment to the requirement in the "Amount of Guarantee" term that the first series of Guaranteed Bonds be issued no later than December 31, 2010. IID's proposal was that this requirement be replaced by a statement of anticipation that such bonds would be issued in 2010, but that the first series of Guaranteed Bonds was not required to be issued until December 31, 2015.

I-Bank staff believe this change is inconsistent with the basis on which the six month extension of the Clarified Preliminary Commitment is proposed, and does not recommend that the I-Bank Board approve a Clarified Preliminary Commitment that incorporates this proposal. I-Bank staff note that IID's proposal could result in the approval of substantially final forms of final guarantee agreements and related reimbursement and indemnification agreements several years prior to finalization of the documents establishing the terms of the obligations that are to be guaranteed.

3. **IID's Proposal Regarding The Term of Guaranteed Bonds:** The Criteria state that "The term of any Bonds shall not exceed 30 years." A difference of opinion regarding how to interpret this limitation arises due to the IID's proposal to issue bonds in at least two series, one in 2010 and the other at some point prior to December 31, 2015.

IID asserts that the IID Guarantee Program anticipated the issuance of bonds by IID, and guaranteed by the I-Bank, over several years, and that for that reason the 30 year maximum

maturity should be determined based on the date of issuance of each series of guaranteed bonds, potentially extending the term of any I-Bank guarantee for more than 30 years.

I-Bank staff cannot conclude with certainty that the I-Bank Board authorized the 2003 Preliminary Loan Guarantee Agreement with the understanding that guaranteed bonds could have a cumulative maturity of more than 30 years. A guarantee that includes an annually reinstated reserve account requirement over 30 years could result in an impact on the State's General Fund in the amount of approximately \$350 million, whereas a guarantee that includes an annually reinstated reserve account requirement over 25 years could result in an impact on the State's General Fund in the amount of approximately \$310 million.

- 4. IID's Proposal Regarding The Subordination of IID's Obligation to Reimburse the I-Bank For Draws Under the Guarantee:** The Criteria require that the I-Bank and IID execute an agreement detailing the I-Bank's right to reimbursement acceptable to the I-Bank. IID proposes that IID's obligation to reimburse the I-Bank for draws under any final guarantee be subordinate to the rights to the Conserved Water Revenues granted to the holders of all other IID debt existing or issued in the future, and after providing for any capital needs of IID. IID has confirmed that its intention is that the I-Bank's right to reimbursement be subordinate to IID capital needs, regardless of whether such capital needs are related to the Water Conservation Project or the production of Conserved Water Revenues.

I-Bank staff are unable to recommend the reimbursement terms proposed by IID. I-Bank staff have agreed to reimbursement from Conserved Water Revenues subordinate to the rights to Conserved Water Revenues granted to the holders of bonds guaranteed by the I-Bank and the holders of any debt existing as of the date of this Preliminary Loan Guarantee Commitment and the holders of any debt subsequently issued in conformance with debt coverage and security requirements approved by the I-Bank.

I-Bank Board Options Regarding Clarification And Reinstatement: The I-Bank Board has three options with regards to the clarification and reinstatement of the terms and conditions of the 2003 Preliminary Loan Guarantee Commitment (which are relevant only if the I-Bank Board extends the term of the 2003 Preliminary Loan Guarantee Commitment):

1. Accept the column entitled "Clarification and Restatement of the 2003 Preliminary Loan Guarantee Commitment" as consistent with the terms of the Criteria for the IID Guarantee Program pursuant to which the 2003 Preliminary Loan Guarantee Commitment was granted;
2. Accept the column entitled "Clarification and Restatement of the 2003 Preliminary Loan Guarantee Commitment" **as amended** by one or more of the proposals in the column entitled "IID Proposal", determining that the amending proposals in the the "IID Proposal" column are within the scope of the Criteria for the IID Guarantee Program pursuant to which the 2003 Preliminary Loan Guarantee Commitment was granted; or
3. Require I-Bank staff to conduct a process to officially amend the Criteria for the IID Guarantee Program consistent with one or more of the proposals in the "IID Proposal" column and in the process obtain public comments to the proposed Criteria amendments. Proposed Criteria revisions, along with the applicable public comment and I-Bank staff

response would need to be presented for review and approval to the I-Bank Board at a later date.

RECOMMENDATION: I-Bank staff recommend that the Board clarify and restate the 2003 Preliminary Loan Guarantee Commitment as set forth in the column of Attachment 1 entitled "Clarification and Restatement of the 2003 Preliminary Loan Guarantee Commitment" (Option 1 identified above) and extend the term for compliance with that Clarified Preliminary Commitment until June 30, 2010.